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Tax Effect of Executor's Rescission and Renegotiation of Decedent's Contracts

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Notes

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I. INTRODUCTION

Under section 1014 of the Internal Revenue Code, a decedent's property acquires a stepped-up basis equal to its fair market value at date of death.[1] However, if the decedent had encumbered the property with an unperformed contract of sale[2] which is fully performed after his death, the stepped-up basis provision is inapplicable.[3] Instead, the recipient of the contract proceeds must recognize section 691 "gross income in respect of a decedent"[4] in an amount equivalent[5] to that which decedent

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1. See INT. REV. CODE OF 1954, § 1014(a). An optional valuation date may be elected under INT. REV. CODE OF 1954, § 2032.

2. An unperformed contract of sale, as used in this Note, refers to a written and signed agreement to sell property under which the purchase price has not been paid, and neither title nor possession transferred to the buyer. The determination of when the gain on the sale accrues is not within the scope of this Note. Generally, a gain from a sale of real estate is not recognized until the transaction is closed. For tax purposes, this means delivery of the deed, possession by purchaser, or payment to seller. Lucas v. North Texas Lumber Co., 281 U.S. 11 (1930). See 2 MERTENS, LAW OF FEDERAL INCOME TAXATION § 12.119 (1961 rev.); SURREY & WARREN, FEDERAL INCOME TAXATION 630-32 (1960 ed.). Moreover, under INT. REV. CODE OF 1954, § 451(b), income is not accrued solely by reason of death.

3. See INT. REV. CODE OF 1954, § 1014(c). Using various theories, several authors have argued against applying this treatment to sales of capital assets. See Krieg & Buschmann, *Section 126: "Items of Gross Income in Respect of A Decedent . . .,"* 32 TAXES 651 (1954); Scott, *A Critique of Section 126,* 26 TAXES 127 (1948); Note, *Income in Respect of Decedents: The Scope of Section 126,* 65 HARV. L. REV. 1024 (1952). However, it is accepted now that there is no exclusion from § 691 for capital sales. SURREY & WARREN, FEDERAL INCOME TAXATION 941 (1960 ed.); Craven, *Taxation of Income of Decedents,* 102 U. PA. L. REV. 185, 212 (1953); Gordon, *"Income in Respect of a Decedent" and Sales Transactions,* 1961 WASH. U.L.Q. 30, 34.

4. INT. REV. CODE OF 1954, § 691(a)(1).

> *General rule*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period . . . shall be included in the gross income, for the taxable year when received of:
> (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;
> (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

would have recognized had he lived to receive the proceeds.[6] If the property has a high market value in relation to decedent's low basis, the resulting gain imposes a heavy tax burden on the estate or successor in interest.[7] This tax burden may be avoided if a new basis for the property could be obtained by rescinding the old contract and reselling the property by further negotiations. This possible savings is illustrated as follows:

Sales Price	$250,000
Decedent's Basis	$ 50,000
Fair Market Value at Date of Death	$250,000

	Contract Performed	Contract Rescinded: New Contract Negotiated
Fair Market Value of Contract[8]	$250,000	$250,000
Other Estate Assets	70,000	70,000
Gross Estate	$320,000	$320,000
Estate Tax[9]	$ 65,700	$ 65,700
Capital Gains Tax on Contract Proceeds[10]	37,825	—0—
TOTAL TAX	$103,525	$ 65,700

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

. . . .

(3) [T]he amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

5. The recipient is given a deduction against the amount of income he reports for that portion of the estate tax attributable to the right to receive the amount. INT. REV. CODE OF 1954, § 691(c).

6. The tax on the income may not be the same for the recipient as it would have been for decedent since their respective tax brackets may differ.

7. If an estate *distributes* the right to income before the proceeds are collected, it does not pay a tax on the transfer; only the distributee includes the receipts in his gross income. See INT. REV. CODE OF 1954, § 691(a)(2).

8. Where the contract is subsequently performed, the fair market value of the contract right rather than the property is included in the estate assets. However, if the contract is rescinded after death the reverse may be true. For the purposes of this Note, however, it is assumed that the two values coincide.

9. In arriving at the taxable estate a specific exemption of $60,000 was allowed, and allowable deductions of $10,000 were taken. See INT.

The purpose of this Note is to determine the availability of this rescission-renegotiation procedure within the present federal tax structure. Three considerations bear upon the question of favorable tax recognition. First, the rescission itself must not be considered a taxable transfer within the meaning of section 691(a)(2). Secondly, the proceeds of the newly negotiated contract must not be deemed "income in respect of a decedent" under section 691(a)(1). Finally, the rescission must not cause the original purchaser to recognize discharge of indebtedness income.[11]

II. TAX CONSEQUENCES TO THE ESTATE OR SUCCESSOR IN INTEREST

A. RESCISSION AS A TRANSFER WITHIN THE MEANING OF SECTION 691(a)(2)

Although it is probably constitutional to impose an income tax upon a seller of property at the time he enters into the contract of sale,[12] the taxable event, or time of "realization of income," is usually postponed to a later part of the transaction.[13] Accordingly, Congress has chosen two events as the time of realization of income from the contracts of a decedent. One such event is the receipt, by the estate or successor in interest, of the contract proceeds;[14] the other event occurs when the estate "transfers" the right to receive the proceeds by a "sale, exchange or other disposition."[15] If the executor rescinds

REV. CODE OF 1954, §§ 2051-55. The tax was computed without considering the effect of credits allowed by INT. REV. CODE OF 1954, §§ 2011-14.

10. Tax on the $200,000 capital gain is calculated by first deducting the estate tax deduction of $58,700, and then using the alternative tax method. See INT. REV. CODE OF 1954, §§ 691(c), 1201. The estate tax deduction is the difference between the tax on the gross estate, including the contract of sale, and the tax on the gross estate excluding the contract of sale.

The taxpayer was assumed to be a widower; when the marital deduction of a spouse is involved, complications as to the § 691(c) deduction arise. For an explanation of how to maximize the § 691(c) deduction when the marital deduction is involved, see Ferrari, *Income in Respect of a Decedent: Deductions, Capital Gains, and Double Deductions*, N.Y.U. 23rd INST. ON FED. TAX 1209 (1965). See also, Treas. Reg. § 1.691(c)-1, ex. 1 (1957).

11. See INT. REV. CODE OF 1954, § 61(a)(12).

12. See Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 HARV. L. REV. 84 (1952); Griswold, *In Brief Reply*, 65 HARV. L. REV. 1389 (1952).

13. See *id.* at 87.

14. INT. REV. CODE OF 1954, § 691(a)(1).

15. INT. REV. CODE OF 1954, § 691(a)(2).

rather than performs the contract, the rescission may be a taxable "disposition" of the right to receive the proceeds under section 691(a)(2).[16]

Arguably, however, rescission is not a type of "transfer" Congress intended as a taxable transaction. Clearly, the section is aimed at preventing a possible loss of tax revenue by a mere transfer of the right to receive such income. This purpose is accomplished legislatively in much the same way that tax revenue was preserved judicially in the assignment of income cases,[17] *i.e.*, by taxing the transferor rather than the transferee, since the transferor received a "benefit" by reason of his original possession of the right.[18] Where this right to receive income is cancelled, rather than donated or sold, the estate has received no benefit from its mere possession of the right; therefore, rescission of the contract should not be considered a "transfer."

In an analogous situation, Congress has expressly elected not to treat contract rescission as a taxable transaction.[19] Prior to the enactment of section 1038 in 1964, if a seller repossessed real property he had previously sold, he recognized a gain or loss on the reacquisition.[20] Congress, however, felt that the seller would not be in any better position after the reacquisition of the property than he was before the sale and that, conse-

16. Section 691(a)(2) provides that if the right

> to receive an amount [of income with respect of a decedent] is transferred by the estate . . . there shall be included in the gross income of the estate . . . the fair market value of such right . . . plus the amount by which any consideration for the transfer exceeds such fair market value. . . .

The statute states that a transfer includes the "sale, exchange or other disposition" of the right to income. If a rescission of the contract is deemed to be a transfer within the meaning of this section the estate would recognize, under a literal reading of the statute, ordinary gross income equal to the fair market value of the contract right at the time of the rescission. This treatment contrasts with that afforded the estate if the contract is performed. In that situation the estate recognizes capial gains income equal to what the decedent would have recognized had he lived. See notes 1-6, *supra*.

17. See, *e.g.*, Lucas v. Earl, 281 U.S. 111 (1930).

18. "Thus, if the right to receive the income is disposed of, as by gift, the donor must include the fair market value of such right in his gross income, in view of his benefit from such right." S. REP. No. 1631, 77th Cong., 2d Sess. 102 (1942); 1942-2 CUM. BULL. 504, 581.

19. See INT. REV. CODE OF 1954, § 1038. "Your committee does not believe that merely because property originally held by a seller has been restored to him should constitute grounds for taxing any appreciation in value of this property to the seller at that time." S. REP. No. 1361, 88th Cong., 2d Sess. 5 (1964).

20. L. D. Codden & Bros., Inc., 37 B.T.A. 393 (1938).

quently, it was desireable to treat the sale as a nullity.[21] Accordingly, section 1038 reversed the prior treatment and enunciated a position commensurate with the traditional view that rescission abrogates the contract ab initio.[22]

B. SUBSEQUENT CONTRACT OF SALE AS INCOME IN RESPECT OF A DECEDENT

Assuming the rescission is not a transfer within the meaning of section 691(a)(2), the proceeds of the newly negotiated contract may nevertheless be taxable as "income in respect of a decedent" within the meaning of section 691(a)(1). For this section to be applicable, the income must in some manner have

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> 21. Apart from any payments he may have received, he actually is in no better position than he was before he made the sale. As a result, your committee has concluded that instead of the repossession of the property being treated as a second sale of the property back to its original holder, it is desirable to consider instead that the first sale has been nullified.

S. REP. No. 1361, *supra* note 19, at 5.

22. Dooley v. Stillson, 46 R.I. 332, 128 Atl. 217 (1925). In Ripley Realty Co., 23 B.T.A. 1247, *aff'd per curium*, 61 F.2d 1038 (1932), the taxpayer sought to have his settlement payments on a breach of contract suit reflected in his prior tax calculation of the sale. The court refused because the suit was for damages, inferring that if it had been suit for rescission the prior sale would have been voided ab initio.

The courts have faced a similar issue when trying to determine if contract cancellation payments resulted from a sale or exchange within the meaning of the capital gains sections of the Code. INT. REV. CODE OF 1954, § 1222. Unfortunately, the decisions are in conflict. See Chirelstein, *Capital Gain and the Sale of a Business Opportunity: The Income Tax Treatment of Contract Termination Payments*, 49 MINN. L. REV. 1, 10 (1964). Those courts which have found a sale or exchange base the result on the theory that rights have been transferred between the parties. See, *e.g.*, Commissioner v. Goff, 212 F.2d 875 (3d Cir.), *cert. denied*, 348 U.S. 829 (1954); Commissioner v. Ray, 210 F.2d 390 (5th Cir.), *cert. denied*, 348 U.S. 829 (1954). See generally 56 MICH. L. REV. 1370 (1958). Other courts say there has been no exchange between parties, rather their respective rights or duties under the contract have been extinguished. See, *e.g.*, Commissioner v. Pittston Co., 252 F.2d 344 (2d Cir. 1958); Marc D. Leh, 27 T.C. 892, *aff'd*, 260 F.2d 489 (9th Cir. 1958). An examination of the factors underlying these decisions does not reconcile the confusion in a way to give a concrete definition to the phrase "sale or exchange" for interpreting the scope of section 691(a)(2). See generally Eustice, *Contract Rights, Capital Gain, and Assignment of Income—The Ferrer Case*, 20 TAX L. REV. 1 (1964); Note, *Capital Gains: Can the Confusion Be Eliminated*, 49 IOWA L. REV. 89 (1963); Note, *The Troubled Distinction Between Capital Gain and Ordinary Income*, 73 YALE L.J. 691 (1964).

The Internal Revenue Service has taken the position that a surrender of simple contract rights is not a sale or exchange of capital assets. Rev. Rul. 531, 1956-2 CUM. BUL. 983. This position was reaffirmed in Rev. Rul. 394, 1958-2 CUM. BUL. 374.

resulted from the decedent's activities.[23] In the leading case of *Commissioner v. Linde*[24] the court specified several factors as determinative of respectiveness: (1) the amounts were realized under and in consequence of contracts and deals made by the decedent; (2) no act or thing taken or performed by the taxpayer (decedent's heir) operated to procure or to give rise to the amount; and (3) the payments had their source exclusively in the decedent's contract and arrangement.[25]

In addition to the above factors, consideration must be given to attacks on the rescission-renegotiation procedure as a tax avoidance scheme.[26] Predicting judicial reactions in the tax avoidance area is difficult;[27] the opinions are myriad and provide no discernible standards.[28] When the courts use such terms as "sham transaction,"[29] "step-transaction,"[30] lack of "business purpose,"[31] and "substance over form,"[32] they are stating conclusions, not guidelines for the practitioner.[33] In conflict are the two broad propositions lying at either end of the tax policy spectrum. On the one hand is the idea that a taxpayer has the right to decrease the amount of his taxes, or altogether avoid them, by any means which the law permits.[34] On the other

23. Davison's Estate v. United States, 292 F.2d 937, *cert. denied*, 368 U.S. 939 (1961); O'Daniel's Estate v. Commissioner, 173 F.2d 966 (2d Cir. 1949); Gordon, *supra* note 3, at 36; Olincy, *Income in Respect of Decedent*, 104 TRUSTS & ESTATES 859 (1965); Note, *Income in Respect of Decedents: The Scope of Section 126*, 65 HARV. L. REV. 1024, 1027 (1952).

24. 213 F.2d 1 (9th Cir. 1954).

25. *Id.* at 4.

26. "Tax Minimization Plan" is a better advocate's term. One author draws a distinction between tax minimization, tax avoidance, and tax evasion for analytical purposes. Lesser, *Business Purpose Revisited*, 14 U. SO. CAL. 1962 TAX INST. 513. However, no court has indicated acceptance of such a distinction.

27. See PAUL, STUDIES IN FEDERAL TAXATION 74 (1937); see generally Rice, *Judicial Techniques in Combating Tax Avoidance*, 51 MICH. L. REV. 1021 (1953).

28. See Rice, *supra* note 27.

29. Knetsch v. United States, 364 U.S. 361, 365 (1960); Bridges v. Commissioner, 325 F.2d 180, 182 (4th Cir. 1963).

30. Du Pont v. Deputy, 23 F. Supp. 33, 37 (D. Del. 1938).

31. Gregory v. Helvering, 293 U.S. 465, 469 (1935); Aldon Homes, Inc., 33 T.C. 582, 597 (1959).

32. Gilbert v. Commissioner, 248 F.2d 399, 404 (2d Cir. 1957). In his dissent in *Gilbert*, L. Hand, J., set out the "beneficial interest" doctrine which was later partially accepted by the Supreme Court in Knetsch v. United States, 364 U.S. 361 (1960). See Blum, *Knetsch v. United States: A Pronouncement on Tax Avoidance*, 1961 SUP. CT. REV. 135.

33. See PAUL, *op. cit. supra* note 27, at 93; Summers, *A Critique of the Business-Purpose Doctrine*, 41 ORE. L. REV. 38, 45 (1961).

34. Gregory v. Helvering, 293 U.S. 465 (1935); Guterman, *Sub-*

is the idea that the public is best served through the collection of the maximum tax under the law, and that no taxpayer should be able to avoid paying his share by means of chicanery and subterfuge.[35] Beyond these statements, generalization becomes hazardous.

The factors espoused in *Linde* suggest that the necessary element of respectiveness would not be present in a situation where the executor negotiates a contract of sale with someone other than the original purchaser. In such a case the new contract would be the consequence of the executor's activities rather than those of the decedent.

The most likely tax avoidance attack upon the rescission-renegotiation procedure in such an instance is the lack of a "business purpose."[36] Although no business purpose is required explicitly by sections 691 or 1014, this general doctrine arose and has continued as a judicial interpretation of congressional intent.[37]

Accordingly, it is necessary to consider the purposes behind these two statutes to see if they embody a business purpose requirement for purposes of our hypothetical. Section 691 is designed to prevent the loss of taxes, solely by reason of death, on income created by the decedent's activities but not yet realizable by him under our tax structure.[38] On the other hand, section 1014 excludes from taxation the appreciation in value of the decedent's property which he had not attempted to realize by affirmative acts.[39] Therefore, it is the activity of the decedent in relation to the accumulated value, rather than the motive of the executor, which determines the applicable statute. Since in our hypothetical it is the executor who bargains for rescission of the old contract, seeks a different purchaser, and negotiates a new contract, it should be immaterial that his sole reason for doing so is to obtain a tax

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stance v. Form in the Taxation of Personal and Business Transactions, N.Y.U. 20TH INST. ON FED. TAX 951 (1962). Quite often when the courts reiterate this policy, they also state that the taxpayer's tax avoidance motive is irrelevant; however, an examination of the opinions reveals that his state of mind is the primary determinate in close cases. See Lesser, *supra* note 26, at 521.

35. See Doyle v. Commissioner, 286 F.2d 654, 659 (7 Cir. 1961).

36. See Fuller, *Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation*, 37 TUL. L. REV. 355, 360 (1963).

37. See Lesser, *supra* note 26, at 543; Rice, *supra* note 27, at 1041-46.

38. See authorities cited at note 23 *supra*.

39. 3A MERTENS, LAW OF FEDERAL INCOME TAXATION § 21.67 (1958).

savings.[40] But for the existence of the contract made by the decedent, the executor could have performed the same activities and obtained the benefit of the tax savings afforded by section 1014.[41] By this analysis, it should not matter whether the executor is able to obtain a more favorable contract, or that the original purchaser is unable or unwilling to perform, both of which are necessary to establish a "business purpose."

A possible variation in the above transaction which might cause a further problem is the existence of prior dealing between the decedent and the second purchaser concerning the same or similar property. This prior connection of the decedent with the new purchaser would revitalize the respectiveness argument. However, in a somewhat analogous situation, the Internal Revenue Service has ruled that some type of contract or arrangement which puts the property beyond the dominion and control of the decedent must be in existence for there to be section 691 income.[42] For example, if a farmer dies leaving unharvested wheat which he had not formally disposed of, the executor should be free to sell the crop to the same buyer with whom the decedent had always dealt without realizing income in respect of the decedent.

Rarely, however, will the property be so readily marketable that the executor would want to risk finding a new buyer.[43] Nor will the purchaser be willing to waive his contract rights without some assurance of a later opportunity to obtain the property at a similar price.[44] Consequently, the only alternative will probably be to deal with the original purchaser. In this

40. In his section entitled *Restatement of Tax Avoidance*, Paul argues that if the steps taken were part of a real transaction, and the facts proved are enough, as a matter of law, to constitute a basis for avoidance, then the taxpayer's motive is immaterial and will not negate the effect of the transaction. PAUL, *op. cit. supra* note 27, at 152.

41. See note 1 *supra* and accompanying text.

42. Rev. Rul. 436, 1958-2 CUM. BULL. 366. See also Gordon, *supra* note 3, at 37; Young, *Tax Treatment of Real Estate Contracts Outstanding at the Vendor's Death*, 42 ILL. B.J. 50 (1953); Treas. Reg. § 1.691(a)-2(b), ex. (5)(1) (1957).

43. There may be a breach of fiduciary duty if the executor rescinds a profitable contract without being able to secure a similarly favorable arrangement.

44. This reluctance suggests an informal agreement whereby the third party would convey the property to the original purchaser after the executor had obtained a stepped-up basis. Such conduit schemes fail so often, however, that it is not necessary to discuss their relative merits and demerits. See, *e.g.*, Gregory v. Helvering, 293 U.S. 465 (1935); United States v. Kyle, 242 F.2d 825 (4th Cir. 1957); Bank of America Nat'l Trust & Sav. Ass'n, 15 T.C. 544 (1950).

situation, there is a more intimate tie-in with the decedent's activities. This element of respectiveness, coupled with the liberal judicial construction of the "right to receive income" provision,[45] increases the difficulty of escaping section 691 treatment. However, the primary obstacles in such cases will be the tax avoidance arguments.

One of the primary tax avoidance arguments is the doctrine of "substance over form."[46] Assume the executor and purchaser agree to rescind the old contract in consideration of a new contract of sale on the same terms. In form, the executor will be trying, by means of a legal paper, to sever the decedent's activity. In other words, he will so substantially inject his presence in the relationship with the purchaser that the contract of sale becomes his product, not the decedent's. In substance, what happens is nothing more than a substitution of sellers' names in the contract. The statute itself performs such a substitution by treating the right to receive the sale proceeds "as if [they] had been acquired by the estate . . . in the transaction in which the right to receive the income was originally derived . . . ."[47] That is, the estate is put in the decedent's shoes for purposes of taxation.[48] Thus, it is clear that mere form alone is not enough to alter the transaction and produce a tax benefit.

To inject more than mere form into the transaction, the sales price could be lowered, in effect paying the purchaser for rescinding the old contract. Such a rescission-renegotiation technique is subject, however, to the pervasive doctrine announced in *Knetsch v. United States*.[49] In that case, the Supreme Court denied the effectiveness of a taxpayer's transaction because it did not appreciably alter his beneficial interest except to reduce his tax. One authority[50] has tried to catergorize this test by saying that any form of transaction, not a sham,[51] which is motivated exclusively by tax savings and not supported by non-tax factors, may be discarded for tax purposes. Some re-

45. See authorities cited at note 23 *supra*.
46. See 5 P-H 1966 FED. TAX SERV. ¶ 41001.
47. INT. REV. CODE OF 1954, § 691(a)(3).
48. See Young, *supra* note 42, at 52.
49. 364 U.S. 361 (1960).
50. Guterman, *supra* note 34.
51. Lesser uses the term "sham" with reference to transactions which are blatantly unreal as in *Haggard v. Wood*, 298 F.2d 24 (9th Cir. 1961). See Lesser, *supra* note 26. However, the courts paint a broader stroke with the term. See, *e.g.*, Knetsch v. United States, 364 U.S. 361 (1960); see Rice, *supra* note 27.

deeming non-tax factors are: (1) an opportunity for profit other than from tax savings; (2) presence of a risk of loss in excess of the possible tax advantages (this does not refer to a loss before taxes deliberately incurred to obtain an after-tax profit); (3) the economic reality of the transaction (sometimes called a business purpose); and, (4) the normality of the forms employed.[52]

Viewed in this light, the success of the new contract is doubtful. The reduction in price, while creating a new right to income in the technical sense, is in reality a built-in loss incurred solely to secure a tax gain.[53] Because the transaction is not supported by any non-tax factors, the respectiveness to the decedent should remain intact.[54]

If the purchaser agrees to rescind the old contract for consideration, and the new contract is not executed until a latter date, there is a better chance of success. The delay between the rescission and the new contract date arguably gives rise to certain non-tax factors. During this time the estate must bear the risks of ownership, such as a possible rise or decline in the market value of the property, the chance of partial or total loss through destruction, and the burden of paying property taxes and insurance. Such factors might convince a court that the estate has earned an increased basis, even though its net proceeds from the transaction are no different than they were in the previous fact situation. This result implies that the presence of non-tax factors will make the taxpayer's motive irrelevant, a position that has been taken by several authorities[55] and some courts.[56]

Nevertheless, there is a danger that prearranging a delay to obtain the resulting benefits may cause a court to revert to the

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52. See Guterman, *supra* note 34, at 952.

53. The taxpayer in *Knetsch* also had a built-in loss; however, his tax gain would have more than compensated him. See Bridges v. Commissioner, 325 F.2d 180, 185 (4th Cir. 1963). *But cf.* John Loughran, 19 CCH Tax Ct. Mem. 1193 (1960).

54. The estate would include in its gross income only the amount of gain actually received, not the amount which would have been realized under the original contract. However, the estate tax deduction is figured on the lesser amount rather than on the value of the contract that had been taxed as an estate asset.

55. See Guterman, *supra* note 33; Lesser, *supra* note 26, at 543.

56. See Stone v. Commissioner, 360 F.2d 737 (1st Cir. 1966); Humphreys v. Commissioner, 301 F.2d 33 (6th Cir. 1962); Fabreeka Prods. Co. v. Commissioner, 294 F.2d 876, 878 (1st Cir. 1961); Maysteel Prods., Inc. v. Commissioner, 287 F.2d 429 (7th Cir. 1961).

"step-transaction" doctrine.[57] This is but another aspect of the "substance over form" argument.[58] In applying it, the courts hold that the tax consequences turn upon the end result, and disregard the intervening steps.[59] A transaction is viewed as comprehending a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship.[60] In the instant case, the end result of the transaction is essentially the same as in the previous situation where a new contract was written with a reduced sales price. A court might conclude, therefore, that both cases should be treated in the same manner—that is, the estate would not receive a stepped-up basis for the property. However, to the extent that the length of time between rescission and renegotiation is increased, courts would be more reluctant to apply the "step-transaction" doctrine because of the incidence of non-tax factors.

III. TAX CONSEQUENCES TO ORIGINAL PURCHASER

One remaining problem with the rescission-renegotiation procedure is that the original purchaser, because of the rescission of the old contract, may realize discharge of indebtedness income.[61]

If the original purchaser is not a party to the new contract and did not receive any consideration for rescinding the old contract, no section 61 income should be attributed to him. He has given up his right to the property in exchange for a release of his payment obligation. Assumedly, the value of this obligation is the same as the fair market value of the property; therefore, his economic position is not improved and no income should result.[62]

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57. See Jockmus v. United States, 335 F.2d 23 (2d Cir. 1964). However, the tax motive alone may not be strong enough to defeat the transaction if the taxpayer bears enough hardships. See Commissioner v. Brown, 380 U.S. 563 (1965) (a bootstrap acquisition of taxpayer's property by a charitable organization); 79 HARV. L. REV. 206 (1965).

58. See Donaldson, *When Substance-Over-Form Argument is Available to the Taxpayer*, 48 MARQ. L. REV. 41, 43 (1964).

59. Minnesota Tea Co. v. Helvering, 302 U.S. 609 (1938); 3 MERTENS, LAW OF FEDERAL INCOME TAXATION § 20.161 (1965 rev.).

60. Du Pont v. Deputy, 23 F. Supp. 33, 37 (D. Del. 1938).

61. See INT. REV. CODE of 1954, § 61(a)(12).

62. Treas. Reg. § 1.61-12(a) (1957). Under this regulation, if the market value of the property is less than the value of the obligation, the purchaser would realize income in the amount of the difference between the two values. Likewise, if the purchaser receives consideration for rescinding the old contract he is in effect giving up a lesser value and will realize income.

Where the original purchaser is a party to the new contract of sale, it is necessary to focus upon the "purchase price adjustment" exception to the discharge of indebtedness rule.[63] Under this exception, the debtor will not realize income provided he still owns the property and the fair market value of the property after the reduction of the purchase price is not in excess of the reduced debt.[64] In the case where the purchaser in effect gets a reduction in the sales price, the market value of the property would be greater than the reduced debt. Consequently, the exception would not apply and the purchaser would realize income in an amount equal to the entire difference between the face amount of the new debt and the fair market value of the property.[65]

IV. CONCLUSION

Although the rescission itself is probably not a "transfer" within the meaning of section 691(a)(2), the proceeds of a subsequent contract are probably income in respect of a decedent under section 691(a)(1) as a consequence of the application of one of several tax avoidance doctrines. However, the application of these doctrines depends upon the specific rescission-renegotiation technique used by the executor. If the executor must deal with the original purchaser, he can increase his chances of success by a rescission for value and a subsequent resale at a later date. If, however, the executor finds a new purchaser, he may be able to avoid adverse tax consequences. Obviously there are possible situations other than those set out which might alter the results indicated. For example, if it is the original purchaser who takes the initiative in rescinding the old contract because he is insolvent or desires a lower price, then, since tax avoidance would not be the doninant motivation, any new contract should be respected.[66] This situation also illustrates the

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63. See Hirsch v. Commissioner, 115 F.2d 656 (7th Cir. 1940); Eustice, *Cancellation of Indebtedness and the Federal Income Tax: A Problem of Creeping Confusion*, 14 TAX L. REV. 225, 244-46 (1959); Greenbaum, *Income from Debt Cancellation and Reduction*, N.Y.U. 19TH INST. FED. TAX 53, 66-67 (1961); Sanders, *Debt Cancellation—Without Realization of Income*, 11 U. So. CAL. 1959 TAX INST. 565, 575-77.

64. See Sanders, *supra* note 63, at 575-76.

65. *Ibid.*

66. Generally, the courts hold that if a taxpayer has two alternate routes to follow, there is no duty to choose the one which will produce the highest tax. Gregory v. Helvering, 293 U.S. 465 (1935); Nassau Lens Co. v. Commissioner, 308 F.2d 39, 45 (2d Cir. 1962). To punish a taxpayer for his choice arguably would undercut the legislative design in providing him an alternative. See Blum, *supra* note 32, at 154 n.64.

importance of ascertaining all the relevant facts and presenting them in the manner best suited to soothing the court's attitude on tax avoidance.[67]

The judicial skepticism toward the meaning urged by a tax-avoiding taxpayer[68] is doubly enforced in the situations discussed in the text. A court faces two statutes, fairly clear in their meaning and not dependent on form for their application, and a taxpayer who by form is trying to escape the burdens of one and reap the benefits of the other. Nevertheless, the lack of any definable tax avoidance theory leaves elbow room for the advocate.

67. See Blum, *supra* note 32, at 140-41.
68. See PAUL, *op. cit. supra* note 27, at 153.